SEC Adopts Proxy Access Rules Making it Easier for Shareholders to Nominate and Remove Directors

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The ability of shareholders to require that the names of shareholder-nominated candidates for the board of directors be placed on the company's proxy statement has long been considered the "holy grail" for shareholder activists. The Securities and Exchange Commission ("SEC") has debated the idea but for 30 years has refrained from action due to concerns about its authority to do so. The passage of the Dodd-Frank Act ("Dodd-Frank") put an end to those concerns by providing the SEC with explicit authority to adopt rules addressing shareholder access to company proxy materials.

Prior to Dodd-Frank, shareholders who wished to nominate directors were required, at their own significant expense, to mount a proxy solicitation through their own separate ballots identifying their slate of nominees. Under the new rules, shareholders or groups of shareholders who meet ownership (3% of the outstanding stock, held for 3 or more years) and other conditions now have access to include their board of director nominees (up to 25% of the board composition) in a company's proxy materials at the company's cost. Shareholders can also include proposals to change the company's procedures for nominations or elections of board members.

For the most part, the SEC has amended other aspects of the securities laws to conform them to this new scheme. For example, shareholders aggregating their holdings to reach the 3% ownership threshold will generally be exempt from having to file the onerous Schedule 13D. The mere fact that they are aggregating to meet that requirement will not cause them to lose "passive investor" status or Schedule 13G eligibility. The SEC has also adopted a new exemption to "solicitations" to allow shareholders to communicate to form nominating groups. However, under this new rule, written communications are significantly limited in content and must be filed with the SEC under cover of Schedule 14N. Oral communications are not limited in content, but notice of them must also be filed on Schedule 14N to qualify for the exemption.1 Shareholders should be aware that these exemptions only apply for shareholders seeking to nominate directors pursuant to Rule 14a-11; they will not apply to shareholders seeking to do so under authority of state law.

When shareholders do pursue these newly granted rights, they must provide all the usual information required of an opposition proxy statement and may also provide a statement of up to 500 words in support of the candidate. Shareholders should be aware, however, that they will be held to the same disclosure standards as the issuers when they file these materials on Schedule 14N. It is the proposing shareholder and not the company who will be liable for any false or misleading statements made with regard to the shareholder's materials if they are included in the proxy statement. Because proposing shareholders can, therefore, be sued, they should use extreme care in their disclosures.2

Companies are not absolutely required to include the shareholder's candidate(s) and materials in the proxy statement. If the company's state of incorporation or the company's governing documents do not permit shareholder nominations, the company can decline to include the shareholder's proposed nomination. The company can also exclude the nomination if the shareholder or the candidate fails to meet the requirements of the new rules. Shareholders will have a brief window to correct technical deficiencies, but may do nothing in the same election cycle to correct deficiencies in the ownership requirement or with the candidate's qualifications. If the company still intends to exclude the nomination after the corrective period, it must file a formal notice of its intention to do so with the SEC at least 80 days before the filing of the definitive proxy statement. After a brief period for a response from the shareholder, the company can request a no-action letter from the SEC.

The SEC has stayed application of these rules pending the outcome of a suit filed by the U.S. Chamber of Commerce and Business Roundtable claiming that the SEC violating its rule-making authority by not properly weighing the cost and burden to the subject corporations. States have significant latitude to adopt their own statutes allowing shareholder proxy access on terms even more beneficial to shareholders, such as lower ownership or holding requirements, or more onerous in other respects. How proxy access will truly play out in the long-term remains to be seen, but savvy shareholders will be cognizant of the interplay between the federal and state schemes in order to best achieve their goals

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1 If ten or fewer shareholders are to be contacted, the group does not have to file written communications or the notice of oral communications with the SEC in order to qualify for the exemption.

2 Delaware allows corporations established under its laws to adopt bylaws that require the proposing shareholder to undertake to indemnify the company for any loss arising as a result of a false or misleading statement submitted by the shareholder. 8 Del. C. §122(6).

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